S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the Matter of the Application of	)	
Michigan Consolidated Gas Company	)	Case No. U-16407
For Approval of a Long-term Main	)	
Renewal Plan	)	

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on July 19, 2011.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before August 5, 2011, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before August 15, 2011. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Mark Eyster

Digitally signed by Mark Eyster
DN: cn=Mark Eyster, c=US, email=eysterm@michigan.gov
Date: 2011.07.19 11:41:22 -04'00'

Mark D. Eyster
Administrative Law Judge

July 19, 2011
Lansing, Michigan

S T A T E O F M I C H I G A N

MICHIGAN ADMINISTRATIVE HEARING SYSTEM

FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the Matter of the Application of	)	
Michigan Consolidated Gas Company	)	Case No. U-16407
For Approval of a Long-term Main	)	
Renewal Plan	)	

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

On June 3, 2010, prior to the commencement of this case, the Michigan Public Service Commission (Commission) issued an Order in Case No. U-15985, (the June 3rd Order) in which, it adopted a Michigan Public Service Commission staff (Staff) proposal recommending that the Commission adopt measures to:

> Require [Michigan Consolidated Gas Company (MichCon)] to dedicate sufficient resources to the main renewal program (which includes cast iron replacement) that would set out a long term plan to significantly reduce the amount of cast iron main in [MichCon's] system. [MichCon] should file a new docket detailing its proposed main replacement program, which will provide the Commission the opportunity to review the planned program and set up a method to monitor [MichCon's] implementation of the program.

Specifically, at page 104 of the June 3rd Order, the Commission directed MichCon to file "a detailed plan for main renewal, including a long term plan to significantly reduce the amount of cast iron main in [MichCon's] system." Additionally, the Commission adopted MichCon's recommendations that the new docket include "an analysis of customer affordability and a determination of the appropriate size of the program[]", "a review of the most appropriate method of financing and segregating [this program] from other [MichCon] capital spending", and "a Commission determination of the most appropriate way to recover the capital costs associated with the program[] from customers."

In response, MichCon filed this application on July 30, 2010. In it, MichCon proposes to implement a 10-year main renewal program, called the Main Renewal Program (MRP)[1]. On September 9, 2010, a pre-hearing conference was held before Administrative Law Judge, Mark D. Eyster. Counsel appeared on behalf of MichCon, Staff, the Attorney General for the State of Michigan (Attorney General), and the Association of Businesses Advocating Tariff Equity (ABATE). At the pre-hearing conference, intervenor status was granted to the Attorney General and ABATE and a schedule was adopted. An evidentiary hearing was conducted on March 7, 2011, at which, the pre-filed testimony of the witnesses was bound into the record, the exhibits were admitted into evidence, and cross-examination was conducted. Briefs were filed on April 14, 2011, and reply briefs were filed on May 5, 2011.[2] The record consists of testimony contained in the 207 page transcript and 26 exhibits.

FINDINGS OF FACT

Introduction

MichCon presented the testimony of three witnesses: Peter M. Rynearson, MichCon's Controller; Todd F. Persells, MichCon's Director,

[1] In its initial filing, MichCon referred to the program as the Main Renewal Initiative. The parties have, since, agreed upon the name Main Renewal Program.
[2] ABATE chose not to file briefs.

Asset Management and Engineering, and; Jennifer C. Schmidt, employed by DTE Energy Corporate Services, LLC as a Principal Project Manager.

Mr. Rynearson provided direct testimony to address the MRP's impact on customers, MRP financing, MichCon's ability to fund the program, how MRP costs will be segregated from other capital costs, and how the MRP's capital costs will be recovered. In addition, Mr. Rynearson provided rebuttal testimony in response to Staff and the Attorney General. Mr. Rynearson sponsored Exhibits A-2 thru A-4.

Mr. Persells provided direct testimony to address the current condition of MichCon's physical distribution system, problems with unprotected mains, the size and components of the MRP, the methodology MichCon will use to determine which mains are to be renewed and retired, MRP costs, MRP impact on cast iron mains, expected benefits of the MRP, and the metrics MichCon plans to use to monitor the MRP's success. He, also, provided rebuttal testimony in response to the Attorney General and Staff. Mr. Persells sponsored Exhibit A-1 and A-5.

Ms. Schmidt testified in rebuttal to Staff and sponsored Exhibit A-6.

Staff presented the testimony of two witnesses: Bonnie Janssen, a Public Utilities Engineer Specialist for the Michigan Public Service Commission, and Kristin Brock, a Gas Safety Engineer for the Michigan Public Service Commission.

Ms. Janssen provided direct testimony discussing and critiquing MichCon's MRP proposal and presented a number of Staff's recommendations. She sponsored Exhibits S-1 thru S-3.

Ms. Brock presented direct testimony addressing the Michigan Gas Safety Standards, MichCon's gas system and operating practices, MichCon's historical commitment to main renewal, MichCon's MRP, and Staff's recommendation for monitoring the MRP. Ms. Brock sponsored Exhibits S-4 thru S-10.

The Attorney General presented the direct and rebuttal testimony of Michael J. McGarry, Sr. Mr. McGarry is President and Chief Executive Officer of Blue Ridge Consulting services, Inc. Mr. McGarry sponsored Exhibits AG-1 thru AG-9.

Because of the nature of this case, it does not easily permit traditional fact finding. Therefore, to a great degree, the findings of fact will focus on a review of the Application and present the opinions and positions of the various witnesses, as presented in the testimony.

<u>MichCon's Application</u>

In its Application, MichCon proposed that, beginning in 2012, it will undertake a ten-year program to renew and retire distribution mains, renew associated service lines, and relocate associated inside meters. MichCon Application, p 3. Each year, MichCon plans to remediate approximately 30 miles of unprotected main. *Id*., p 3-4. MichCon plans to limit the annual average cost of the MRP to $1.58 per customer in the first year of the program with costs growing to $22.23 per customer in year ten. *Id*., p 4. MichCon's projected annual capital expenditure for the MRP, in 2012 dollars, is $17.1 million. *Id.* MichCon proposes to set up a separate budget and tracking mechanism for the MRP. *Id*., p 5. As MRP projects are placed in service, they are to become part of MichCon's rate base and accounted for in accordance with the Uniform System of Accounts. *Id*. Upon Commission approval of the MRP, MichCon anticipates the need to regularly file rate cases to recover the cost of service for future MRP costs. *Id*. MichCon made clear that, "[i]n this Application, [it was] not seek[ing] recovery of any costs. Thus, a Commission order . . . approving MichCon's proposed [MRP] will not result in an increase in the rates of any customers." *Id*., p 6.

For relief, MichCon requested that the Commission find that MichCon's proposed MRP: i) is a reasonable and prudent long-term main renewal and retirement plan of appropriate size with sufficient dedicated Company resources that will significantly reduce the amount of cast iron main in MichCon's system; ii) provides the Commission the opportunity to review the planned program and monitor MichCon's implementation of the program; iii) is a reasonable and prudent expenditure of capital costs that customers will consider affordable when recoveries of the costs are approved for recovery in future general service rates[3], and; iv) is based upon reasonable and prudent method of financing which will be reflected on the Company's books and records in a manner that allows the segregation of this plan from other MichCon capital spending.

[3] As explained below, MichCon has changed this position and, now, asks for approval to implement a surcharge in this docket.

MichCon's Testimony and Exhibits

A copy of MichCons' proposed MRP was admitted into evidence as Exhibit A-1. At Tr 2, p 61, Mr. Persells explains that:

> The [MRP] is a 10 year plan to renew and retire unprotected[4] main across MichCon's distribution system. In simple terms, main renewal is the process of replacing old mains, which are projected to experience leak rates in excess of other mains. Main retirement is the process of retiring mains that are no longer needed to serve customers in an area due to population and load decreases. In addition to the renewal and retirement of unprotected distribution mains, the program will include the renewal of service lines, where appropriate, and the relocation of any inside meters encountered during the renewal of the main. The [MRP] covers an initial 10 year period, beginning in 2012. During this time, MichCon will remediate the most significant areas of deteriorating distribution main in its system.

The MRP is expected to accelerate main renewal to a level that will stabilize the rate of new gas main leaks. Tr 2, p 61. MichCon hopes to average 15 miles of main renewal and 15 miles of main retirement, annually. Tr 2, p 63. MichCon believes this properly balances customer affordability and distribution system infrastructure improvement. Tr 2, p 65.

To identify the best candidates for main renewal, MichCon will use its Main Replacement Prioritization program. Tr 2, p 66.

> The Main Replacement Prioritization program is a dynamic engineering model that projects the deterioration of MichCon's unprotected main by providing an expected leak rate for each main segment. The Main Replacement Prioritization program predicts leaks per mile per year (leak rate) for each pipe segment based on factors including age, previous leaks, diameter, material and other leaks in the general area of the main. The main segments with the

[4] The "term 'unprotected' distribution main includes cast and wrought iron, and bare steel and coated steel main that is not cathodically protected". Tr 2, p 62. "MichCon has 18,599 miles of distribution main in its service territory. Of this amount, 3,938 miles is classified as unprotected main with about 2,525 miles of cast iron, 268 miles of bare steel, and 1,145 miles of coated steel. Unprotected main is more prone to leaks . . .". Tr 2, p 62.

> highest projected leak rates are then ranked using a risk model. The risk model calculates a risk score based on three assessment criteria: 1) probability assessment, 2) impact assessment, and 3) mitigation assessment. . . . The highest ranked candidates are potentially the worst performing mains and are prioritized for renewal the following year.

To determine the candidates for main retirement, MichCon will examine its automated mapping system and customer service billing system to identify main segments that do not directly supply customers. Tr 2, p 66. Once identified, "[i]f the segment is not needed to supply other customers and is unprotected, it is added to the retirement list and becomes a main retirement candidate." Tr 2, 66-67.

MichCon anticipates that approximately 40% to 70% of the main renewal will target cast iron. Tr 2, p 67.

As originally proposed, Mr. Rynearson explains that the MRP is estimated to cost $17.1[5] million per year, in 2012 dollars, over ten years. Tr 2, p 39. MichCon's estimated annual Cost of Service for the MRP is $1.4 million in the first year, rising to $26.7 million in the tenth and consists of "(1) 'return on' and 'return of' capitalized program costs, and (2) property taxes that will be expensed during the year." Tr 2, p 39. Exh A-2. As stated, at Tr 2, p 39-40:

> The majority of [MRP] costs will be capitalized and amortized by utilizing the depreciation and Standard Retirement Units (SRU's) that were approved . . . in Case No. U-15699, MichCon's last depreciation case. The "return of" program cost is the annual depreciation of these capitalized costs that will be recovered over the first 10 years of the program. The "return on" program cost is the Pre-Tax Rate of Return MichCon needs to recover underlying

[5] Of the $17.1 million, approximately $12.1 million will fund 15 miles of main renewal, including associated service renewals and meter relocations, and $5.0 million will fund 15 miles of main retirement. Tr 2, p 68.

> Long-Term Debt costs and a Return on Common Equity used to finance the unamortized program costs that were capitalized.

The MRP's average annual cost, per customer, is estimated to be $1.14 in the first year of the MRP, rising to $23.27 in its tenth. Tr 2, p 42. Exh A-4. MichCon estimates annual savings of $132,000 because of reduced lost gas and reduced O&M costs for leak repair.[6] Tr 2, p 42.

MichCon indicates that it has $170 million available, annually, for capital spending and it proposes to fund the MRP with this internally generated cash. Tr 2, p 43. If MichCon's investment needs are projected to exceed its internally generated capital funds, it will file a general rate case to propose ways to generate additional capital. Tr 2, p 44. In such case, MichCon might propose "traditional debt/equity funding, a separate surcharge for the MRI, approval for accelerated depreciation, or other reasonable options to provide sufficient cash flow." Tr 2, p 44.

MichCon will establish a separate budget and project tracking account for the costs of the MRP. Tr 2, p 45. After projects are placed in service, they will be part of MichCon's overall capital and accounted for in accordance with the Uniform System of Accounts. Tr 2, p 45-46.

Pursuant to the testimony of Mr. Rynearson, at Tr 2, p 46:

> MichCon intends to file for recovery of [MRP] related capital expenditures in future rate cases. MichCon will use projected costs and revenues for the [MRP] capital expenditures to develop future test year revenue requirements under Act 286, MCL 460.6a(1). After Commission approval of the capital expenditures associated with the [MRP], MichCon intends to file a rate case that will include the costs of Main Renewal as approved in this docket and as approved by DTE's Board of Directors.

[6] The $132,000 figure includes $46,000 for gas and $86,000 for O&M. Tr 2, p 70.

Staff has proposed use of a surcharge and submitted a proposed surcharge tariff sheet that includes a two page document entitled Main Replacement Program Rider Requirements (MRPRR). Among other things, the MRPRR outlines the MRP and Staff's surcharge calculations. Revised Exh S-2. In rebuttal, MichCon indicated that the tariff sheet should be relabeled Sheet D-2.0 and objected to inclusion of the MRPRR. Tr 2, p 87. "If MichCon were to include this sort of information for every rate charged, [MichCon's] rate book would become unnecessarily large and confusing." Tr 2, p 90. In addition, MichCon disagrees with MRPRR language that limits recovery to the cost of main renewal, which limits the precedential value of this case, that establishes the surcharge's effective date, and that all customers pay the surcharge. Tr 2, 49.

<u>Staff's Testimony and Exhibits</u>

Staff supports MichCon's proposal to replace or retire 30 miles of pipe in each year of the MRP's ten years. Tr 2, p 102. However, Staff calls for the implementation of the plan in 2011, rather than in 2012.

Staff disagrees with MichCon's treatment of depreciation and property taxes in its proposed cost of service model. Explaining Staff's position, Ms. Janssen states, at Tr 2, p 103:

> MichCon is replacing and retiring mains that are currently in its rate base and Staff does not recommend that the annual depreciation and property taxes of the new mains be recovered before they are included in rate base. Staff sees a double counting of hypothetical and not actual costs if these costs are included as part of the Company's carrying cost. Staff further believes that the Company should have commitment to the program that includes some sharing by the part of its shareholders.

At Tr 2, p 104-07, Staff outlines additional modifications to the MRP, by stating:

> Referencing Exhibit S-1, and Exhibit S-2, Staff has made several modifications and additions to MichCon's MRP. Since Staff is recommending that the Company began the program in 2011, the costs for the first year have been adjusted downward from $17 million to $11.0 million. Staff has used the Company's proposed incremental capital investments for the proposed next four years and their projected Operational and Maintenance (O&M) savings. Staff is calculating the return on investment by using the pre-tax cost of capital of 12.20%, but instead of a one year rate that would be updated annually with their actual costs and O&M savings, Staff is proposing a five-year average rate with an expiration date as detailed in Exhibit S-2. . . .
>
> * * *
>
> Because of the company's past failures, MichCon must show they have spent their dollars appropriately in this case. Staff proposes a five-year expiration for the program as a trial run for the Company spending the dollars on this specific MRP. Under Staff's proposal, there are costs and time savings to the Company if it maintains the program as proposed. The costs and savings of the MRP are shown on Exhibit S-1. If the Company files a general rate case within the next five-years, the whole MRP process will start over with another five-year period to determine the corresponding surcharge per rate schedule with new expiration date five years after the implementation of the new surcharge. With the five-year average rate, and if the Company costs and O&M savings are properly projected as delineated on page two, the Company would be able to surcharge its customers the rate per month per customer per rate schedule over the next five years, starting June 2012 as calculated on page three of Exhibit S-1. If the Company incurs expenses above or below the projected costs during this five-year period, the surcharge stays the same. If their expenses continue to increase and the Company needs to file a general rate case to adjust the MRP costs, they may do so at that time. Correspondingly, the five-year average rate will be adjusted and put into place as determined by the Commission. If expenses are lower than projected, then the Staff would recommend that the Company replace more main so its capital expenditures are approximately the same as those delineated on page two of Exhibit S-1.
>
> * * *
>
> As calculated on Exhibit S-1, page three of three, . . . Staff proposes allocating the costs to each Rate Schedule as determined in [the June 3rd Order], via the Cost of Service Study

> (COSS) Main Allocation Factor of Average and Peak on summation of the first five-year average. Once that allocation has been calculated, then the total amount per rate schedule would be divided again by the number of customers also approved [in the June 3rd Order], and divided again by 12 to arrive at a cost per customer per rate schedule per month. This spreadsheet has two sets of rates listed. The first set of rates does not set a maximum rate for any customer. It is strictly the main average and peak allocation factor from the COSS multiplied by the five-year average of costs from page two divided by the number of customers per rate schedule and by 12 to arrive at a rate per month per customer per rate schedule as calculated on line seven. The second set of rates on page three limits the rate per customer to a maximum of $500.00 per month . . . . for the transportation rates XLT and XXLT customers. Any amounts above [$500] per customer were redistributed to the other rate schedules and a new surcharge per month per customer per rate schedule was calculated on line 20. Staff supports the maximum rate of $500 per month for these customers over the alternatively proposed rates per month in excess of $1,000 per month. These rates are tabulated on Staff's proposed tariff sheet for this MRP [surcharge] on Exhibit S-2, page three. Under Staff's five-year rate, the Company would be able to charge its customers the same rate for up to five years. The rate would begin with the billing cycle of June 2012 and expire with the billing cycle of May 2017. The Company would need to file a general rate case to change its MRP rate, extend the [surcharge] for another 5 years, and transfer its capital expenditures into its base rates.

Included in Staff's proposed surcharge tariff sheet is a two page document entitled Main Replacement Program Rider Requirements (MRPRR). The MRPRR outlines the MRP and Staff's surcharge calculations. Exh Revised S-2. Staff proposes to include the MRPRR in MichCon's rate book.

Staff agrees with MichCon's proposal to file an Annual Report by March 31 of each year, but adds that the report should provide all the information listed in Exhibit S-2. Tr 2, p 107. In addition, Staff proposes that, by May 20 of each year, after review of the annual report, Staff will file a report with the Commission making "any necessary recommendations". Tr 2, p 107. In addition to the

Annual Report, Staff is recommending an annual October 31st filing to begin in 2011. Tr 2, p 122. The October filing would include the planned activities for the following year and would be in the same format as page 5 of Exhibit S-10. Tr 2, p 122.

<u>Attorney General's Testimony and Exhibits</u>

In sum, at Tr 2, p 134, the Attorney General's witness, Mr. McGarry states his opinion that:

> MichCon's [MRP] will put a burden on ratepayers without significantly improving the safety and reliability of [its] main distribution system. In addition, the Commission should reject any pre-approval of the capital costs associated with the [MRP] that MichCon may seek when it files for recovery in future base rate cases.

More specifically, Mr. McGarry expresses his concern that the MRP fails to discuss "some basic and important elements", that MichCon includes a 30% contingency in its costs estimates, and that "MichCon has not completed its Distribution Pipeline Integrity Management Plan as required under 49 CFR Part 192 Subpart P. Tr 2, p 137. At Tr 2, p 137, Mr. McGarry states that:

> [The Distribution Pipeline Integrity Management Plan] would, in part include a section which:
>
>> *Identify and implement measures to address risks.* Determine and implement measures designed to reduce the risks from failure of its gas distribution pipeline. These measures must include an effective leak management program (unless all leaks are repaired when found).[8]
>
> . . . MichCon indicated that . . . it is to complete this plan by August 2, 2011 . . . . This plan would have a significant impact on the estimates of replacement as the plan requires that the Company either implement an effective leak management program or demonstrate that all leaks are repaired when found. This could significantly impact the costs and potential O&M savings

associated with the [MRP] . . . .

[8] 49 CFR **§ 192.1007**

Additionally, Mr. McGarry criticizes MichCon for failing to include a "forecast of specific projects and associated costs for the respective upcoming construction season" in its annual March filing. Tr 2, p 138. Finally, he opines that the "plan lacks sufficient information to allow the Commission to pre-approve a program that will impact customers for 10 years." Tr 2, p 139.

In response to Staff's proposed annual October report, Mr. McGarry suggests the additional requirement that MichCon report "estimated cost information and information concerning retirements." Tr 2, 162.

Additionally, Mr. McGarry expresses numerous concerns with Staff's proposals. First, he argues that by accelerating the program, Staff increases the cost to $186,549,000. Next, Mr. McGarry explains a number of concerns he has with Staff's cost recovery recommendations. At Tr 2, p 165-168, he states:

> The Commission should reject this proposal as not meeting the regulatory precedents, rules and regulations that are consistent with the development of rates in Michigan. Staff is recommending the Commission set rates for the cost of this program based on the average of five years of future costs. At best, the Staff should only recommend a twelve month future test year beyond the implementation of the rates which would coincide with what is done in a typical rate case. Staff is also creating an inter-generational equity issue wherein today's ratepayers are paying for plant in-service and retirements based on future costs for plant and retirements that would not be in service for at least 3½ years.[14] From Exhibit Revised S-1, Staff shows that in 2011, the Net Annual costs is $1,295,500 for 2011, $2,039,700 for 2012 and $2,079,470 for 2013 for a total cumulated cost of $5,414,670 for the three year period. However, Staff is expecting to pay $5,455,702 in each of these three years. Therefore, in 2011 customers now are paying 4.2 times ($5,455,701 ÷ $1,295,500) what they should otherwise pay (again assuming Staff's incorrect methodology). Now, in years 2014 and 2015 Staff's proposed plan goes the other way where customers then are paying less than they should which further

exacerbates the inter-generational equity issue where earlier customers are subsidizing rates of future ratepayers. On this basis alone, the Commission should reject Staff proposed surcharge.

* * *

[Additionally], Staff is allowing the Company to earn a full years return on year 1 in 2011. Staff's analysis assumes that 100% of the $11 million is in service on January 1, 2011. Line 2 of Staff's analysis shows the full $11 million x 12.20% to arrive at a capital charge of $1,342,000. This is incorrect and why revenue requirements calculation use an averaging of rate base/capital additions to represent timing of those additions. Obviously, the Company should not be allowed (even as part of an average) to earn a return on additions that are not in service for a full term and certainly only interest for the period where the plant is in service. In addition, Staff's analysis excludes the effects of depreciation and taxes. Traditional rate regulation allows the utility to earn on cumulative "net rate base" after accounting for the depreciation reserve. Staff's calculation does not reflect that aspect of regulatory accounting. In essence, Staff is setting rates based on a hypothetical year that does not properly reflect those aspects of regulatory rate making. Finally, Staff is including a full years' credit for the Leak Savings Offset. It won't be until after the total mains and services are renewed or retired that the savings will start to accumulate. Staff's analysis assumes that 100% of the savings have started to accrue on January 1. This is simply not the case. I would ascribe that the way in which the Company has presented the revenue requirement for the program as shown in Company Exhibit A-2 Page 1 of 1 is the appropriate way to calculate the revenue requirements.

[There are other problems and inconsistencies with Staff's analysis, as presented in Exhibit S-1.] Staff is including what it terms "leak savings offset." In each year, Staff is reducing the Capital charge in Column C by $46,500 to arrive at the "Net Annual Costs" in Column E. Staff does not discuss this number in its testimony. However, I assume that Staff is referring to the one part of the Company's "cost savings impact" as described by Company Witness Persells in his testimony at page TFP-13 line 22. In that calculation, the Company proposes a $46,000 estimated annual cost savings associated with lost gas and another $86,000 for the reduction in O&M expenses related to the elimination of leak repairs on the system as the mains and service are renewed or retired. In addition to the accrual of a full year's savings in the first year, Staff's analysis fails to take into account the cumulative O&M savings and those O&M savings that will accrue from moving meters to the outside[15]. Finally, Staff's analysis levelized the leak savings offset while at the same time escalating the capital investment costs. This is an example of the flaws in Staff's methodology and the Commission should reject the entire calculation.

[14] The 2.5 years of the average time before the "average" is achieved plus the regulatory lag of a rate case, assuming approximately 11 months.

[15] In reviewing Staff's analysis, I noted that . . . MichCon also failed to include the O&M savings with moving the meters to the outside . . . .

POSITIONS OF THE PARTIES

MichCon

In its Initial Brief, MichCon argues that its filing "accomplishes the . . . requirements set forth in the June [3rd] Order in a manner that properly balances customers' ability to pay for the program, the Company's ability to finance the capital costs, and speed at which MichCon will be replacing and renewing the poorest performing natural gas mains within its distribution system." MichCon Init Br, p 4.

MichCon adds, at MichCon Init Br, p 14-16 that:

> MichCon proposes to use internally generated cash to fund its MRP capital needs.
>
> * * *
>
> In the event that the sum of all the investment needs is projected to exceed its internally generated funds for capital, MichCon would file a general rate case to propose the most cost effective way to generate the additional capital that is needed.
>
> * * *
>
> MichCon will set up a separate budget and project tracking process to account for costs under this project. . . . Once projects are placed into service they will be part of MichCon's overall capital and accounted for in accordance with the Uniform System of Accounts. Depreciation rates . . . would be same as those approved in the then latest MichCon Depreciation case (currently Case No. U-15699).
>
> MichCon proposed to file for recovery of MRP related capital expenditures in future rate cases. After Commission approval of

> the capital expenditures associated with the MRP, MichCon would file a rate case that would include the costs of Main Renewal as approved in this docket and as approved by DTE's Board of Directors. As long as the general rate case process is used to recover the MRP costs from MichCon's customers, there is a strong likelihood that MichCon will need to file regular rate cases to recover the cost of service of future MRP investments.
>
> During the course of this proceeding, Staff filed testimony proposing that the Commission also approve in this case a surcharge or rider to recover the costs of the MRP. While MichCon's proposal assumed that the surcharge for the MRP would be approved in a future general rate case filing, the Company believes that the Commission can in this case approve the implementation of a surcharge contemporaneous with implementation of the MRP, and recommends that the Commission do so particularly if the start of the MRP is accelerated to 2011.

MichCon does, however, recommend changes to Staff's surcharge proposal. First, MichCon argues, at MichCon Init Br, p 17, that:

> Staff's MRP surcharge does not allow for the retirement of mains in which a portion of the main could be protected steel, copper or plastic. The Company believes Staff Exhibit S-2, Page 1, item 1 should be adjusted to say, "Unless required for the replacement or retirement of unprotected metallic main, the costs associated with the removal and replacement or abandonment of protected steel, copper, or plastic mains or service lines should be excluded from the MRP recovery mechanism."

Second, MichCon argues that the capital cost reviewed in this proceeding "should be given precedential value and not subject to a second additional review . . . in conjunction with MichCon's next general rate case." MichCon Init Br, p 17. Third, "[i]f the MRP implementation is to be accelerated to 2011 . . ., which is not contested by the Company, the corresponding MRP surcharge should be effective on a billed basis on the date of the Commission's Order in this case, with an expiration date five years after that date."

MichCon Init Br, p 17-18. To delay the surcharge, MichCon argues, would be unconstitutional. MichCon Rep Br, p 13-14.

MichCon also takes issue with Staff's revenue calculations and states, at MichCon Rep Br, p 18:

> The revenue requirements computation proposed by Staff includes items that Staff witness Janssen considered inappropriate. However, such items are included in Exhibit S-2, p. 1, item 6), MichCon has no issue with the exclusion of items such as deferred taxes, accumulated depreciation, and property taxes and simply seeks assurance that the revenue requirement computation discussed in testimony is the one adopted by the Commission as opposed to the computation set forth in Exhibit S-2, p. 1, item 6). In addition, Staff proposed that the revenue requirement be based on a five-year average of MRP cumulative costs. Further Staff maintains that the MRP costs be comprised of a "return on" the incremental capital cost, net of projected O&M savings. The Staff proposal only allows the Company to recover carrying costs for the capital expenditures between general rate case proceedings. Just as the Staff has excluded other real costs, such as property taxes and depreciation, it should not then include O&M savings. More importantly, there are no O&M savings for costs currently being recovered in base rates. Rather there are only future avoided costs that are not a reduction in costs from MichCon's last filed rate case.

In response to Staff's proposal to apply the surcharge to Special Contract customers, MichCon states, at MichCon Rep Br, p 19, that:

> Special contracts are subject to rates (usually fixed), terms, and conditions that are different than the tariff rates terms and conditions that apply to all other customers. These unique terms have been negotiated with a specific customer and subsequently approved individually by order of the Commission. Therefore, MichCon cannot levy the MRP surcharge on Special Contract customers and any reference to the Special Contracts rate schedule should be removed from the MRP Rider and those costs, similar to the surcharge for large end users over $500, should be spread to the remaining rate classes.

MichCon opposes inclusion of the MRP guidelines in the rate book. MichCon Rep Br, p 17.

MichCon continues and argues, at MichCon Rep Br, p 18-19:

> Staff's proposed tariff sheet provides for no reconciliation of carrying charges or other costs to the revenue collected. In fact with the proposed use of a 5 year average surcharge, the base rate revenue surcharge will exceed costs in the first years of the program. [MichCon] is not precluded from filing a rate case proceeding during the period the surcharge is in effect and Staff's proposal allows the Company to reset the MRP surcharge following a rate case order. Therefore if Staff's proposal is adopted by the Commission, the Commission should also find that to the extent the Company under- or over-recovers the cost of the MRP, the shortfall or excess recovery will not carryover to the next five year program recovery surcharge or be a normalization adjustment in a future rate case proceeding. Since there is no over/under recovery, no regulatory asset accounting is required nor would MichCon request approval to establish regulatory asset accounting in conjunction with the base rate surcharge being proposed.

MichCon adds, at MichCon Rep Br, p 15:

> If the Commission believes that approval of an MRP surcharge is not ripe for consideration in this case, then the second option is to approve all of the component parts of the MRP in this proceeding including the monitoring reports, but also determine that the implementation date of the MRP will coincide with the Commission's order in a future proceeding that establishes a surcharge to recover the costs of the MRP. It is important to recognize that selecting this option does not mean that main renewal work will not continue. . . . [F]or 2011 [Mich Con] will continue to perform planned and unplanned main renewal work as part of its routine capital spending, but at a higher level than the average historical spend over the 2005-2009 timeframe.

In Conclusion, at MichCon Init Br, p 18-19, MichCon requests issuance of a Commission order finding that:

> i) MichCon's proposed Main Renewal Program is a reasonable and prudent long-term main renewal and retirement plan of appropriate size with sufficient dedicated Company

resources that will significantly reduce the amount of cast iron main in MichCon's system;

ii) MichCon's proposed Main Renewal Program provides the Commission the opportunity to review the planned program and monitor MichCon's implementation of the program;

iii) MichCon's proposed Main Renewal Program is a reasonable and prudent expenditure of capital costs as set forth in Exhibit A-1, page 24 that customers will consider affordable;

iv) MichCon's proposed Main Renewal Program is based upon reasonable and prudent method of financing which will be reflected on the Company's books and records in a manner that allows the segregation of this plan from other MichCon capital spending;

v) MichCon should be authorized to collect the surcharges as set forth in Exhibit A-6 contemporaneous with the expenditures required to implement this program[7]; and

vi) Grant such other and further relief that is deemed just and reasonable.

Staff

In general, Staff supports the MRP, with modifications. It is the issue of cost recovery where Staff's proposal varies most from MichCon's. The points of agreement and proposed modifications are discussed, below.

Staff agrees with MichCon's proposal for an Annual Report to be filed by March 31st. However, as explained at Staff Init Br, p 19:

> In addition . . ., Staff recommends that the March 31st report provide the data specified on Revised Exhibit S-2 and account for all planned and unplanned main renewal costs separately. Staff will review the report and will make any recommendations in a report by May 20th of each year. MichCon will have the ability respond to the Staff's recommendations. . . .
>
> In addition, Staff proposes that MichCon file a MRP planning report in this docket annually by October 31st. . . . The October planning report should include MichCon's Planned Main Renewal Candidate List and the Planned Main Retirement Candidate List by for the upcoming year. This information should be provided in the same format as page 5 of Exhibit S-10. Staff requests that

[7] The request varies from that requested in the Application, in which, MichCon specifically stated it was not request recovery of costs in this proceeding.

> MichCon file its first MRP planning report on October 31, 2011 for the 2012 calendar year.

Staff believes this multiple reporting process will ensure continual review and compliance with the MRP. Staff Init Br, p 19.

Staff next turns to the cost of the MRP. Staff acknowledges that "[w]hile . . . the Commission does not typically hold separate proceeding[s] to examine individual costs, this process is not unheard of." Staff Init Br, p 20. However, [t]o make this proceeding consistent with the Commissions [June 3rd Order], Staff believes that it is appropriate to review the MRP in its entirety, which includes approving a reasonable level of costs associated with the MRP." Staff Init Br, p 21. At Staff Init Br, p 21-23, Staff continues by stating:

> Staff agrees with MichCon's proposal to capitalize the infrastructure replacement costs and stretch out the period over which the costs are recovered. This is beneficial to MichCon's customers and shareholders. Staff also agrees with MichCon's proposal to use its pretax rate of return to recover its underlying long-term debt costs and a return on common equity used to finance the unamortized program costs that were capitalized. As . . . identified on page one of Exhibit A-2, the pre-tax cost of capital [is] 12.20 %. Additionally, Staff agrees that carrying costs should be recovered to help prevent margin erosion from regulatory lag.
>
> MichCon's return on its MRP costs should not include the Company's depreciation rate and property tax. The mains being replaced and/or retired are currently in MichCon's rate base. By allowing the Company to recover the annual depreciation and property taxes of the new main, this is in effect permitting recovery of hypothetical costs — not the costs actually incurred. Staff believes that this method of recovery in unreasonable. Moreover, by not allowing the Company to recover these hypothetical costs, MichCon will have to demonstrate a greater commitment to the program by forcing its shareholder to pay for some of cost of the MRP.
>
> As opposed to the Company's proposed annual cost per customer rate increase, Staff recommends adopting a five-year average fixed rate schedule for MichCon's customers. Staff's

> proposed fixed rate schedule is seen on page 3 of Revised Exhibit S-1. In developing its fixed five-year average rate schedule, Staff used the Company's proposed incremental capital investments, the projected O&M savings, and a calculated return on investment pre-tax cost of capital of 12.20%. . . . [T]he purpose for Staff's five-year average fixed rate schedule is to ensure that MichCon commits to the MRP. . . . Staff recommends requiring MichCon to show how the funds set aside for the MRP have been spent. Staff further recommends a five-year expiration for the program as a trial run and notes that there are costs and timesavings to the Company if the MRP is maintained.
>
> Under Staff's proposed modification, a rate case proceeding would commence the evaluation of the surcharge per rate schedule. Every time the Company files a new rate case, an evaluation of the MRP will occur along with determining another 5-year average fixed rate.

Revised Exhibit S-2 is a copy of the tariff and MRPRR language that Staff proposed for inclusion in MichCon's rate book. Staff Init Br, p 27. Revised Exh S-2. Staff agrees with MichCon's request to amend the MRPRR to include cost recovery for main retirement. At Tr 2, p 26-27, Staff describes additional changes it believes should be made to its tariff language, by stating:

> Staff [believes] the surcharge's effective date should be commenced sooner. However, the notice of hearing did not advise customers of a potential rate increase and the Company's Application indicated, "In this Application, MichCon does not seek recovery of any costs. Thus, a Commission order in this case approving MichCon's proposed [MRP] will not result in an increase in the rates of any customers." Therefore, Staff proposes the following language change to Revised Exhibit S-2, page 1, item 5, and page 3:
>
> > that if the program is to be accelerated to 2011 as proposed by Staff, and not contested by the Company, that the corresponding MRP surcharge should be effective on a billed basis on the date of the Commission order in the next general rate case, with an expiration date of five years after that date.
>
> Additionally, . . . Staff agrees with the Company that "the revenue requirement components on Staff Exhibit S-2, page 1, item 6, include irrelevant items such as deferred taxes, accumulated

depreciation and property taxes," (2 TR 51) and should be removed.

As modified by Staff, Staff recommends Commission approval of the MRP. Staff Init Br, p 28.

Attorney General

The Attorney General argues that it appears MichCon is seeking pre-approval of $17.1 million for the MRP with a determination that these costs are reasonable and prudent. AG Init Br, p 7. The Attorney General argues that "MichCon should not be give[n] preapproval of any expenditures and should have to demonstrate that the benefits exceed the costs [of the MRP]." AG Init Br, p 8. The Attorney General notes that the costs are currently projections for a ten-year period and argues that "[a]ny future rate case should review . . . actual costs . . . to ensure proper accounting, expenditure, and new forecast[s]". AG Rep Br, p 11. The Attorney General opposes Staff's proposal to implement a surcharge to finance the costs of the MRP and to begin the program on 2011. AG Init Br, p 8, 9. As to accelerating the program in to 2011, the Attorney General argues that this is unjustified "micro-managing". With regard to the surcharge, the Attorney General finds "Staff's testimony . . . misleading . . . and as such does not justify imposing a surcharge on MichCon's customers that the Company is not seeking." AG Init Br, p 9. The Attorney General adds that Staff's surcharge is based on a five year average of costs and creates "an inter-generational equity issue wherein today's ratepayers are paying for plant in-service and retirements based on future costs for plant and retirements that would not be in service for at least 3½ years." AG Init Br, p 10.

Next, the Attorney General argues that the Commission should reject Staff's proposed surcharge calculation. At AG Init Br, p 11, the Attorney General explains:

> Mr. McGarry pointed out several significant flaws in Staff's methodology and calculation of the surcharge. These included allowing the Company to earn a full year's return on year 1 in 2011. Mr. McGarry points out that "This is incorrect and why revenue requirements calculations use an averaging of rate base/capital additions to represent timing of those additions. Obviously, the Company should not be allowed (even as part of an average) to earn a return on additions that are not in service for a full term and certainly only interest for the period where the plant is in service." In addition, Mr. McGarry opined, "Staff's analysis excludes the effects of depreciation and taxes. Traditional rate regulation allows the utility to earn on cumulative 'net rate base' after accounting for the depreciation reserve. Staff's calculation does not reflect that aspect of regulatory accounting. In essence, Staff is setting rates based on a hypothetical year that does not properly reflect those aspects of regulatory rate making. Finally, Staff is including a full years' credit for the Leak Savings Offset. It won't be until after the total mains and services are renewed or retired that the savings will start to accumulate. Staff's analysis assumes that 100% of the savings have started to accrue on January 1." Mr. McGarry . . . concludes that the revenue requirement for the program as shown in Company Exhibit A-2, page 1 of 1, is the appropriate way to calculate the revenue requirements.
>
> Mr. McGarry also found that Staff's O&M savings analysis is incorrect. In addition to the accrual of a full year's savings in the first year, Staff's analysis fails to take into account the cumulative O&M savings and those O&M savings that will accrue from moving meters to the outside. Finally, Staff's analysis levelized the leak savings offset while at the same time escalating the capital investment costs. These are examples of the flaws in Staff's methodology, and as such Mr. McGarry recommended that the Commission should reject the entire calculation.

The Attorney General opposes approval of the surcharge, in part, because doing so would "reward MichCon for not taking the appropriate steps in the past to mitigate the need for such an expensive capital program." AG Rep Br, p 9. Further, the Attorney General argues that "[i]mplementing a surcharge with no advanced notice to customers is untenable" and continues, at AG Rep Br, p 10, by arguing that:

> [MichCon] stated that it would seek approval of a possible surcharge only if circumstances were such that the project exceeded its ability or its capital costs were insufficient to internally fund the project. After Staff proposed a surcharge, the Company changed its position to agree with the surcharge. Yet the Company has provided no compelling reason why it cannot proceed with internally generated funds as envisioned by its own proposal.

The Attorney General agrees with Staff's proposal to require an October 31 planning report and recommends additional information related to costs and retirements. AG Init Br, p 11.

For several reasons, the Attorney General argues that the Commission should find that MichCon's Application has failed to meet the directives from Case No. U-15985. First, the Attorney General feels that the MRP is a costly burden upon ratepayers without providing additional safety. AG Init Br, p 12. Instead, the Attorney General recommends that MichCon be "encouraged to improve its existing programs and take advantage of as many opportunities as it can to replace, renew, or retire mains. AG Init Br, p 12.

Finally, at AG Init Br, p 13, the Attorney General argues that:

> Mr. McGarry points out that the Company has not completed its Distribution Pipeline Integrity Management Plan as required under 49 CFR Part 192 Subpart P. This plan would, in part, include a section which would identify and implement measures to address leak related risks [with] distribution pipeline. Per the requirements of the CFR, these measures **must include an effective leak management program** (unless all leaks are repaired when found). . . . [MichCon] indicated that . . . it is to

> complete this plan by August 2, 2011. . . . This could significantly impact the costs and potential O&M savings associated with the [MRP] should the Company's distribution pipeline integrity management plan go beyond what is envisioned in the [MRP]. Mr. McGarry concluded that, "To simply force the Company into a replacement program where the benefits cannot be proven or justified is not appropriate especially in the tough economic times that the State of Michigan and MichCon's customers are currently experiencing."

DISCUSSION

Mandates of the June 3rd Order

In the June 3rd Order, the Commission directed MichCon to file, in a new docket, a "detailed plan for main renewal, including a long term plan to significantly reduce the amount of cast iron main in Mich Con's system" June 3rd Order, p 104. Additionally, the Commission adopted both Staff's and MichCon's MRP related recommendations. Pursuant to those recommendations, MichCons' filing must sufficiently detail its MRP to "provide the commission the opportunity to review the planned program and set up a method to monitor Mich Con's implementation of the program." June 3rd Order, p 103. Furthermore, as found at June 3rd Order, p 103, this docket is to address:

> (1) an analysis of customer affordability and a determination of the appropriate size of the [MRP];
> (2) a review of the most appropriate method of financing and segregating [the MRP] from other Mich Con capital spending; and
> (3) a Commission determination of the most appropriate way to recover the capital costs associated with the [MRP] from customers.

Compliance with the June 3rd Order

Detailed Plan and Cast Iron

In its June 3rd Order, the Commission directed MichCon to file a detailed plan for main renewal that included a long term plan to significantly reduce the amount of cast iron main. With this filing, MichCon has done so. A copy of the MRP was submitted as Exhibit A-1. In it, MichCon details its 10-year plan to remediate the most deteriorated main in its system. On an annual basis, the MRP targets 30 miles of main for removal or retirement. While MichCon plans to prioritize the MRP to target its worst performing lines, it estimates that 40% to 70% of the MRP will address cast iron. Over the ten-year period, this would result in the removal of approximately 120 to 210 miles[8] of cast iron from MichCon's system. In addition, among other things, Exhibit A-1 details MichCon's plans to exclude unplanned and routine renewals from the MRP, to include associated service lines and meters, and its use of its Main Replacement Prioritization program to identify appropriate mains for renewal. The MRP, also, details projected costs, operational benefits, and cost savings. Based on the above and having considered the remainder of the record and the parties' arguments, I find that MichCon has filed a detailed plan for main renewal that includes a long term plan to significantly reduce the amount of cast iron main.

Commission Review and Monitoring

The June 3rd order directed MichCon to "provide the Commission an opportunity to review the planned program and set up a method to monitor [its] implementation".

---

[8] This equates to approximately 4.8% to 8.3% of MichCon's current cast iron main.

MichCon has provided the Commission an opportunity to review the MRP.

With regard to monitoring, MichCon originally proposed filing an Annual Report by March 31st, beginning in 2013. As proposed, the Annual Report will detail the cost of each renewal/retirement project, the number of affected service lines, the number of meters relocated, and the number of leaks remediated.

Staff proposes additional reporting requirements including: the footage and costs of mains renewed and retired, the corresponding unit and cost of service of lines renewed or retired, the costs of meter relocation and removal, and an accounting of all planned and unplanned main renewal costs. Staff also proposes a procedure for its review of the Annual Report and the opportunity to issue recommendations in its own report by May 20th of each year. MichCon would then have the opportunity to respond to Staff's recommendations.

In addition, Staff proposes that MichCon file a MRP Planning Report by October 31st of each year, starting in 2011. The Planning Report would include MichCon's Planned Main Renewal Candidate List and the Planned Main Retirement Candidate List by for the upcoming year, both in the same format as page 5 of Exhibit S-10.

The Attorney general agrees with Staff's proposed Planning Report and recommends the inclusion of additional information related to costs of each proposed project.

All of the above proposals are adopted. MichCon shall file its first MRP Planning Report by October 31, 2011 and its first MRP Annual Report by the following March 31st. By doing so, the Commission will have an appropriate method to monitor MRP implementation.

<u>Determination of the MRP's Appropriate Size and Analysis of Customer Affordability</u>

In the June 3rd Order, the Commission stated that "an analysis of customer affordability and a determination of the appropriate size of the program[]" "should be addressed".

MichCon has decided that MRP resources should be set at a level that stabilizes its system's level of incoming leaks. Using its Main Replacement Prioritization program, MichCon believes the targeting of fifteen miles of main for renewal and fifteen miles of main for retirement will accomplish this goal. MichCon estimates that doing so will cost $17.1 million, in 2012 dollars, annually. This breaks down to approximately $12.1 million for fifteen miles of main renewal and $5.0 million for fifteen miles of main retirement, including associated service renewals and meter relocations. Over the MRP's initial 10-year period, MichCon projects expenditures of $186.5 million. MichCon estimates the cost of service for the MRP to equal $1.4 million in the first year, growing to $26.7 million its tenth year. MichCon estimates that this translates to an average annual cost per customer of $1.14 in the MRP's first year, growing to $23.27 in year ten. MichCon estimates that, in 2012, for a typical residential customer, this results in an 1% increase in distribution costs.

Upon completion, MichCon projects savings of $46,000, annually, because of avoided lost gas. Additionally, MichCon projects the MRP to lower O&M by $86,000, annually. The Attorney General expects additional savings;

the result of meter relocation. Under MichCon's proposal, these savings would be reflected in a future rate cases.

Staff supports the size of the MRP. In general terms, the Attorney General disagrees with MichCon's proposal because of the limited cost/benefit analysis that has been conducted and because, he feels, MichCon has failed to establish that the MRP will improve safety.

MichCon considers this affordable to its customers. While proposing a surcharge structure to recover costs, Staff, generally, supports the overall cost of the MRP. The Attorney General recommends that the Commission reject the MRP and considers its costs a burden on customers that will not significantly improve safety and reliability.

To a degree, the Attorney General's protestations warrant consideration and may have merit. The basis for his concerns stem from his position that the record, in this docket, does not support the significant expenditures associated with the MRP. However, in the June 3rd Order, the Commission stated it was "time for Mich Con to commit to addressing" the problem of deteriorating mains and directed MichCon to file a main renewal plan that included a long-term plan to reduce the amount of cast iron mains. Therefore, while the Attorney General raises legitimate concerns, the Commission has spoken quite clearly on the need for this program and I will not revisit the merits of a main renewal plan.

Having considered the record, the Attorney General's concerns, and that MichCon and Staff agree on the size of the MRP, I find that its size is appropriate. As to affordability, the Commission directed MichCon to include, in this filing, an analysis of customer affordability; it has done so.

Most Appropriate Method of Financing and Segregating the RMP from other MichCon Capital Spending

In its June 3rd Order, the Commission stated that "a review of the most appropriate method of financing and segregating [the RMP] from other [MichCon] capital spending" "should be addressed".

MichCon proposes to use internally generated cash to fund the MRP's capital requirements. MichCon estimates that, under current conditions, it has approximately $170 million cash available for annual capital spending. It, also, estimates that, under current conditions, with inclusion of the MRP, it has $170 million of annual capital spending. However, if the sum of its investment needs is projected to exceed its internally generated capital funds, MichCon expects to file a general rate case to determine the most cost effective manner of generating additional capital. In a general rate case, MichCon envisions consideration of traditional debt/equity funding, a separate surcharge, and accelerated depreciation. MichCon indicates that, as alternatives, MichCon could lower dividends or DTE could increase investment in MichCon.

To segregate MRP spending, MichCon proposes to establish separate budget and project tracking. Once projects are placed in service, they will become part of MichCon's overall capital and accounted for in accordance with the Uniform System of Accounts. Then current depreciation rates would apply.

By its filing, MichCon has reviewed an appropriate method of financing and segregating the RMP from other MichCon capital spending. MichCon's proposals are adopted.

<u>Commission Determination of the Most Appropriate way to Recover MRP Capital Costs from customers.</u>

In its June 3rd Order, the Commission stated "a Commission determination of the most appropriate way to recover the capital costs associated with the [MRP] from customers" "should be addressed".

In its Application, MichCon made very clear that a general rate case was the proper forum to address cost recovery and that it was not seeking the recovery of any costs in this proceeding. However, after reviewing Staff's surcharge proposal, MichCon changed its position and adopted both the idea of a surcharge and a request for Commission authorization to collect it.

While now favoring a surcharge, MichCon, none-the-less, identified a number of disagreements with Staff's proposal. Points of contention include the proper calculation of the surcharge, language to be included in the tariff sheet, Staff's position "that the revenue distribution and accounting provisions from the MRP should have no precedential value" in MichCon's next rate case, its application to Special Contract customers, and the surcharge's effective date.

Finally, and noteworthy, in its Reply Brief, MichCon argues and clarifies its position, by stating, at MichCon Rep Br, p 18-19, that:

> Staff's proposed tariff sheet provides for no reconciliation of carrying charges or other costs to the revenue collected. In fact with the proposed use of a 5 year average surcharge, the base rate revenue surcharge will exceed costs in the first years of the program. [MichCon] is not precluded from filing a rate case

> proceeding during the period the surcharge is in effect and Staff's proposal allows the Company to reset the MRP surcharge following a rate case order. Therefore if Staff's proposal is adopted by the Commission, the Commission should also find that to the extent the Company under- or over-recovers the cost of the MRP, the shortfall or excess recovery will not carryover to the next five year program recovery surcharge or be a normalization adjustment in a future rate case proceeding. Since there is no over/under recovery, no regulatory asset accounting is required nor would MichCon request approval to establish regulatory asset accounting in conjunction with the base rate surcharge being proposed.

In its briefs, Staff reversed its position on whether the Commission should immediately approve collection of a surcharge. Staff, now, argues that because the establishment of new rates was not contemplated with this filing, no cost recovery should be ordered in this docket. The Attorney General has held that position throughout. Staff, the Attorney General, and, as originally filed, MichCon, all agree that the appropriate way to recover the capital costs of the MRP is in a general rate case. I, also, agree.[9]

CONCLUSION

For the reasons stated above, MichCon has fulfilled the directives given it by the Commission in its June 3rd Order.

The MRP is adopted, as amended above.

Any evidence, facts, and arguments not specifically addressed in this Proposal for Decision were deemed irrelevant to the findings and conclusions of this matter.

[9] Because rates will be determined in a future rate case, I do not feel it best to decide, now, whether a separate surcharge should be adopted. Currently, the parties disagree as to the details of a surcharge. By deferring this decision, the parties to this case and, almost certainly, additional parties will have additional time to consider alternatives to and/or the proper structure of a surcharge in the context of a general rate case.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Mark Eyster

Digitally signed by Mark Eyster
DN: cn=Mark Eyster, c=US, email=eysterm@michigan.gov
Date: 2011.07.19 11:41:45 -04'00'

Mark D. Eyster
Administrative Law Judge

July 19, 2011
Lansing, Michigan
drr